

## Young Commercial Farmers: Their Financial Structure and Credit Sources

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*Recent declines in new entrants into farming have raised concerns about the effectiveness of policies that aid new entrants. The growing capital requirements of today's production agriculture often are linked to the decline in persons entering farming. Research indicates most young commercial operators have ample financial resources. A small group has more limited financial resources and is more likely to need assistance in the form of grants or subsidized credits. These young low resource operators primarily obtain their credit through commercial banks and USDA farm loan programs. The results suggest that broad-based targeting of assistance programs based on age, or even years of experience, may be inappropriate.*

Recent USDA research suggests that between 1992 and 2002, 500,000 older farmers will stop farming, to be replaced by only 250,000 new young farmers (Gale). For decades the declining number of new entrants into farming has been a public policy concern. High capital requirements per farm are often cited as a barrier faced by new entrants. To provide a more complete understanding of the financial constraints faced by *young operators*, we examine their financial structure, income, and credit sources.<sup>2</sup> This is accomplished using data from USDA's *Farm Costs and Returns Survey (FCRS)* covering 1991-92.

We focused on farm operators under the age of 40 who could be considered full-time farmers. Farm operators under the age of 40 total about 440,000 and represents 21 percent of all U.S. farms. Of these, only 140,000 (7 percent of U.S. farms) are considered *commercial*. The remaining 300,000 are considered to be *noncommercial* operators. Distinct structural differences exist between *young commercial* and *noncommercial* operators, especially concerning their reliance on farm income. Only 29 percent of young *noncommercial* operators were considered *farming dependent*, compared with 86 percent for young *commercial* operators. Commercial farm operators well-being will be primarily dependent on farm business financial performance. The well-being of *noncommercial* operator households, on the other hand, is more likely dependent on nonfarm factors. Hence, this analysis focuses primarily on young *commercial* farm operators.

Young *commercial* operators with less than \$150,000 net worth (*low resource*) represent about 40,000 farm operators or 1.9 percent of all U.S. farms. Young *commercial* operators with \$150,000 or more in net worth (*established*) represent about 100,000 or nearly 5 percent of all U.S. farms (table B-1). The \$150,000 net worth level is the lowest

The *FCRS* is a multiple frame survey conducted annually by USDA. Each farm surveyed represents a number of similar farms. It provides annual data on the financial and structural characteristics of all farm operators in the U.S. (Morehart, Johnson, and Banker).

*Commercial farms* reported greater than \$50,000 in annual sales, the operator's primary occupation was farming and the operator contributed 1,500 or more hours of labor to the farm business. *Noncommercial farms* represented all other farms.

*Farming dependent* was defined as receiving less than \$20,000 in nonfarm income and a majority of total household income is from the farm business.

*Young operators* were defined as being under 40 years of age while *older operators* were 40 years or older.

*Low resource young operators* were defined as commercial farmers under 40 years of age and having less than \$150,000 of net worth (capital).

*Established young operators* were defined as commercial operators under 40 years of age and reporting \$150,000 or more of net worth (capital).

*Financially stressed* farms reported negative net farm income and debt-to-asset ratios greater than 0.40.

*Returns on assets* were defined as (Net farm income - management charge - unpaid family labor + interest paid)/total assets]. The imputed management charge, 5 percent of the net value of production, was consistent with other USDA studies using *FCRS* data.

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<sup>2</sup> See box for definitions of terms in italics.

### **Defining a Young Operator**

There is no standard definition of either a young farmer or a beginning farmer (new entrant). USDA defines a beginning farmer for the purposes of its farm credit programs as having no more than 10 years of farm experience. Farm experience is broadly defined by having day-to-day labor and management experience in the farm business. Other than being an adult, there are no age thresholds for eligibility to USDA's credit programs for beginning farmers.

The Farm Credit Administration (FCA) is required to report annually on the Farm Credit System's service to young, beginning, and small farmers. For reporting purposes, FCA defines young farmers as those under 35 years of age and beginning farmers as having less than 6 years of farm experience. Small farmers have less than \$100,000 in farm assets and less than \$40,000 in farm sales.

Following these broad guidelines, we define a young operator as being under 40 years of age. Data limitations restricted using years of farming experience to define new entrants. However, analysis of FCRS data for previous years found that about 80 percent of commercial farm operators under 40 years old reported less than 11 years of farming experience. Therefore, commercial farm operators under 40 should also be representative of new commercial entrants.

**Table B-1—Balance sheet for commercial farms, by operator age and net worth classification**

1991-92 averages	Under 40 years of age		Over 39 years of age
	Low resource	Established	
	<i>Dollars per farm</i>		
Total assets	174,024	694,511	799,029
Total current	37,290	134,230	141,085
Total noncurrent	136,734	560,281	657,944
Farm equipment	49,696	132,067	116,710
Breeding livestock	19,012	43,414	45,876
Land and buildings	67,521	381,523	489,541
Other	505	3,277	5,817
Total debt	95,267	141,143	118,220
Current	40,137	53,476	46,578
Operating loans	26,932	33,510	30,506
Other	14,271	21,254	16,709
Noncurrent	55,129	87,667	71,641
Nonreal estate	10,003	15,792	11,711
Real estate	45,126	71,874	59,931
Net worth	78,758	553,368	680,809
Debt per farm: 1/			
Farm Credit System	7,130	26,001	33,517
Commercial banks	34,859	48,085	39,296
USDA	29,297	10,328	14,113
Individual	7,357	19,418	10,579
Other lender	9,377	27,074	12,343
Market shares of debt by lender:		<i>Percent</i>	
Farm Credit System	8	20	31
Commercial banks	40	37	36
USDA	33	8	13
Individuals	8	15	10
Other lenders	11	21	11
Total	100	100	100
Distribution of lender's total farm operator debt: 2/			
Farm Credit System	1	14	56
USDA	11	11	47
Commercial banks	4	16	41
Individuals	3	20	35
Other lenders	3	24	34
Total debt	4	16	43

1/ Farm operator debt which does not include accounts payable and accrued interest payments, is not comparable to total debt above. 2/ Distributions total across to 100 percent when noncommercial farms are included.

threshold that could be used given sample size limitations. Increasing the threshold to \$250,000 expands the number of low net worth operators to about 70,000 or 3.5 percent of all U.S. farms. Sharp differences exist between these groups with respect to financial structure and performance and their sources of credit.

## Financial Structure

The differences between low resource and established young commercial operators appeared very dramatic. On average, the value of assets held by young low resource operators is \$500,000 less than that of established young operators. Much of this difference can be explained by the value of land and buildings each group controls. Established young operators have a \$315,000 greater investment per farm in land and buildings than the low resource group. Established young operators also have significantly larger investments in machinery and equipment, as well as livestock.

Young low resource commercial operators display more financial stress than established young commercial operators. Low resource young operators carry greater debt relative to their total asset base and income-producing assets than do established young operators. They report an average debt-to-asset ratio of 0.54—much higher than the average 0.20 for established young operators. Also, 13 percent of low resource young operators are categorized as *financially stressed*, having negative net farm incomes and debt-to-asset ratios greater than 0.40. This compares with only 3 percent for established young operators. There are no significant differences in the debt structure, as both groups display about the same distribution of debt between current and noncurrent liabilities.

Because they owned more farm assets and had a relatively light debt burden, established young operators reported much more net worth per farm than low resource young operators. The net worth for low resource operators is less than \$79,000, far less than the \$553,000 reported by established young operators.

The characteristics of established young operators more closely resemble the characteristics of older commercial operators than those of young low resource operators. The debt-asset ratio of established young operators is only slightly higher than the average for operators over 40 years of age. Although less, the net worth of the established young operators compares closely with that of older commercial operators.

## Sources of Credit

Young low resource commercial operators obtain nearly three-quarters of their financing needs from USDA and commercial banks. (Credit programs of the former Farmers Home Administration were transferred to USDA's Consolidated Farm Service Agency in late 1994). Banks supply 40 percent of this group's financing needs, slightly more than their 38-percent share of total farm operator debt. USDA was the

primary source of credit to low resource livestock farms, while commercial banks were the primary source to crop farms.

As expected from its mission, USDA's farm credit programs hold a small share of the total debt owed by established young commercial operators. While USDA is a primary supplier of credit to low resource young farmers, the bulk of USDA's credit goes to other classes of farmers. The largest share of USDA's farm operator debt (47 percent) is owed by older commercial operators. This is probably attributable to previous efforts by USDA to stabilize established young operators experiencing financial problems. This might change over the coming years as USDA targets an increasing share of its lending resources to young and beginning farmers, as required under 1992 legislation.

The Farm Credit System (FCS) does not appear to be active in financing young low resource commercial operators, as it has only an 8 percent market share for the group. Regardless of whether the farms specialized in livestock or crop production, FCS market share was significantly less than that of commercial banks or USDA. Only 1 percent of total farm operator debt held by FCS is owed by low resource young commercial operators. For established young operators, the FCS market share is larger, but still substantially less than for older commercial operators. The small FCS market shares can not be explained by the fact that young operators are low tenure and, therefore, own proportionally less real estate. The ratio of real estate liabilities to total debt for young low net worth operators is not very different than for other categories of operators.

When purchasing real estate or other farm assets, young operators with little money for down payments would be expected to negotiate directly with sellers for a contract of sale. However, this does not appear to be true, as individuals had only an 8-percent market share of debt owed by young low resource farmers.

## Income Statement

At \$109,000, average gross cash farm income of low resource young operators is half that of established young operators (table B-2). Also, most expense items are proportionately higher for the low resource group. The proportionately higher expenses of low resource young operators leave them with proportionately lower net farm incomes. The net farm income for the low resource group is only one-fourth that of the established group.

Low resource commercial farmers operate a little less than half the acres of established young operators (table B-3). Low resource young operators are much more dependent on leased farmland than other commercial operators. It might be expected that low resource young operators would be more dependent on cash rented rather than share rented acres because landlords would find this group more risky and request cash payments up front. This is not evident, however, as reliance on cash rent is the same for both groups.

**Table B-2—Income statistics for commercial farms, by operator age and by net worth classification**

1991-92 averages	Under 40 years of age		Over 39 years of age
	Low resource	Established	
			<i>Dollars</i>
Farm income:			
Gross cash income	108,919	218,147	205,590
Crop sales & CCC	52,042	106,300	91,565
Livestock sales	41,591	87,095	91,108
Def. & disaster payments	6,761	9,525	7,892
CRP payments	249	658	912
Other farm-related	8,276	14,568	14,113
Total cash expenses	92,031	169,009	162,084
Variable expenses	66,502	129,746	130,892
Farm origin	23,238	41,980	45,889
Manufactured inputs	21,057	38,859	35,295
Labor	6,476	20,804	22,821
Other	15,732	28,104	26,887
Fixed expenses	25,529	39,263	31,192
Net cash farm income	16,888	49,138	43,506
Depreciation expense	8,680	20,867	15,096
Net inventory change	217	8,652	6,287
Other noncash items	1,380	3,575	4,114
Net farm income	9,806	40,497	38,811
Household: 1/			
Total household income	24,622	47,224	49,702
Income from farming	14,427	33,825	30,232
Income from off-farm sources	10,195	13,398	19,470

1/ Farm income to the household included self-employment income plus amounts that operators pay themselves and other family members to work on the farm, net income from other farm business, and income from land rent.

**Table B-3—Selected statistics for commercial farms, by operator age and net worth classification.**

1991-92 averages	Under 40 years of age		Over 39 years of age
	Low resource	Established	
			<i>Number</i>
Total U.S. farms	38,400	103,400	328,400
			<i>Acres</i>
Land utilization:			
Operated	506	1,183	1,384
Owned	73	388	627
Cash rented	262	348	340
Share rented	178	225	193
			<i>Percent of farms</i>
Renting some machinery	20	22	14
Specializing in:			
Livestock	47	48	51
Crop	53	52	49
Financially stressed 1/	13	3	4
Positive cash farm income	80	87	84
Positive net farm income	74	79	78
Farming dependent 2/	86	86	81
Farms with more than one household	1	16	15
Average operator age (years)	32	35	56
Annual hours of operator labor	2823	3186	2907
Average returns on assets (percent)	-1.2	4.3	2.6

1/ Defined as having negative net farm income and debt-asset ratio greater than 0.40. 2/ Less than \$20,000 of nonfarm income and a majority of total household income is from the farm business.

Compared with older commercial operators, young operators are more likely to use leasing as a credit source, at least for machinery. However, there is not a significant difference in machinery leasing rates between low resource and established young operators. There is no significant evidence of livestock leasing within either group of operators.

A large percentage (80 percent) of low resource young operators report positive incomes. However, these operations also supply a large amount of unpaid operator labor (2,823 hours) relative to established young operators (3,186 hours) who had twice as much gross farm income and four times as much net farm income. The combination of low farm income (\$9,806) and large amounts of unpaid labor produces a negative *return on assets* of -1.2 percent. This implies that these operators are receiving less than the minimum wage for their labor.

Nearly all low resource young operators have only one household depending on income from the farm. Therefore, most of these operations likely are one-family operations independent of parents. In contrast, 16 percent of the established young commercial operations have more than one household depending on the farm business for income. Multiple households likely indicate the presence of a parent who has retired from farming and is transferring management and farm assets to the on-farm heirs.

## Conclusions

The growing capital requirements of today's modern agriculture are frequently linked to the decline in the number of new entrants into commercial farming. The research presented here shows two distinct groups of young commercial operators. The group with the largest number farm operators displays high levels of financial resources and is unlikely to face major capital constraints. The smaller group reports limited financial resources and is likely to be constrained by the cost and availability of capital.

The dilemma faced by beginning and young farmers has been a popular policy concern. Federal and State programs recently have been enacted that assist these farmers (Wallace). Also, there likely will be some debate concerning young and beginning farmers as Congress considers the upcoming farm bill. Our results provide some insight into the need for and the likelihood of success of these programs. Using operator age or years of farming experience as a criteria for determining eligibility for credit programs may be inappropriate. While low resource young operators may benefit from special credit programs, more established operators will be able to obtain credit from conventional sources. The results suggest eligibility criteria should consider several factors such as net worth, household income, or total assets owned.

Low resource young operators receive a large portion of their financing from USDA. Hence, any legislative change that affects USDA's lending programs could affect the availability of credit to low resource farmers. Commercial banks are also a large provider of credit to low resource farmers and may be able to fill this gap if USDA's lending programs are curtailed.

Commercial banks' presence in financing low resource young operators could be due to their active participation in USDA's guaranteed loan programs. Likewise, the minimal FCS presence could be due to its lack of participation in the guaranteed program. Unfortunately, the FCRS does not include information on guaranteed loans.

Young commercial operators with low resources can often benefit from low interest loans and low down payment options. However, the extra income generated by these programs is not sufficient to make young low resource farmers more competitive with established young commercial operators. Low resource young operators typically lack the asset base to generate incomes sufficient to cover living expenses and provide for growth. To prosper, these operators might need an infusion of capital such as nonfarm equity such as limited partnerships.

In addition to providing low interest rate loans and low down payment options, policymakers could also consider options that encourage nonfarm equity investments. For example, State and Federal laws restricting the use of limited partnerships or subchapter S corporations could be examined. Tax incentives could be provided for nonfarm investors in low resource farming operations. Also, private institutions could be encouraged to provide grants to operators who are productive and efficient but have limited resources.

## References

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